As I see

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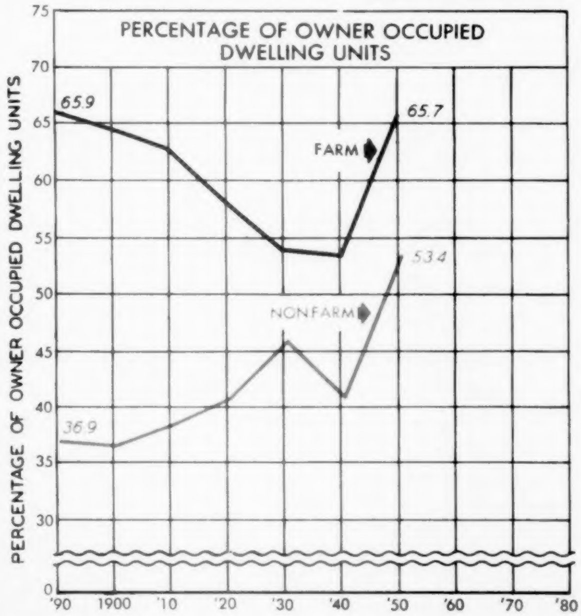
HOW HIGH SHOULD MORTGAGE INTEREST RATES BE ?

A civilization resting upon the shoulders of renters, boarders and roomers is never secure. From the earliest times to the present, the individual who owns his own home has always been the individual who could be relied upon to accept his share of civic responsibility. Among community leaders, the percentage of home ownership is amazingly high.

I think we can take for granted that home ownership is desirable and should be encouraged wherever possible. Owned homes are better maintained than rented ones. There has been no change in the general sentiment which Arthur Young expressed in 1787, when he said: "Give a man the secure possession of a bleak rock, and he will turn it into a garden; give him a nine years' lease of a garden, and he will convert it into a desert."

Just as there cannot be any doubt that home ownership is a strong bulwark to a nation, neither is there any doubt that low interest rates encourage home ownership and make it possible for many low-income families which otherwise could not afford it, to own their own homes.



Home ownership has been increasing in the United States since 1900, with a temporary setback during the Big Depression. The chart to the right will show that it has increased each 10 years until 1930, with a very sizable increase from 1920 to 1930.

The 1940 figure is a result of the Big Depression, and the 1950 figure the result of the long-time trend, accentuated by low interest rates and by the fact that rent control took a large percentage of rental units off the market, forcing persons desiring a home to buy, even though they might prefer to rent. Insofar as the high percentage

of ownership in 1950 was due to the unwilling ownership of this latter group, the ending of rent control and the emergence again of units for rent may have a tendency to decrease this very high percentage.

● How can money be made available to persons desiring to become home owners? It seems to me there are only three possible ways: 1. it can be saved; 2. it can be borrowed from those who have saved it; and 3. it can be created by government.

1. The difficulty with accumulating the money by saving is that the amount necessary is generally so great that it becomes impossible for the average young couple to save enough in the earlier years of their married life to purchase a home. If this purchase must be deferred until the entire amount is accumulated, many people will not be able to become home owners until they have passed middle age, and some will never be able to accumulate the required amount.

2. If the money is borrowed from those who have saved it, the borrower necessarily must compete with other borrowers for these savings, and the lender who has accumulated the money will lend out his capital in such a way that he will receive the greatest return consistent with the safety of his principal. If money is to be borrowed from those who have it, the borrower is in competition with the bond market, the stock market, savings and loan associations, savings banks and the Federal government, which are all willing to pay the lender for the use of his funds. This means that if conservative common stocks can be bought to yield 6 or 7%, the lender is going to take this fact into consideration in determining the interest charge he will make when he lends out his funds to any borrower. If the Federal government, which in 1941 paid lenders 0.1% on 90-day Treasury bills, has now found it necessary to pay 2.32%, it would indicate that lenders are finding that they can now lend their funds with complete liquidity and with no risk for a greatly higher amount than they were able to 10 years ago.

This month the Federal government took subscriptions on a new 30-year bond issue which will yield 3-1/4%. This is the highest rate paid on any similar issue in more than 20 years, but this is still considerably below the average mortgage interest rate.

In my opinion, the volume of residential building will decrease in the period ahead, but the decrease will not be due primarily to an increase in interest rates. For a number of years we have been building at a rate faster than the rate of new family formation, and it seems to me that the shortage in most communities no longer exists and the demand from those who are able and willing to pay for a house at today's high costs is shrinking rapidly.

● Why is it necessary that the prospective home owner should pay a higher amount than the amount paid on government bonds?

The lender who lends money on a real estate mortgage does not have a riskless

investment, nor does he have an investment from which he can get back his money at will, nor does he have an investment where interest and principal payments are obtained without effort and where no accounting records must be kept.

The risk involved in making a mortgage on today's market consists in the following items:

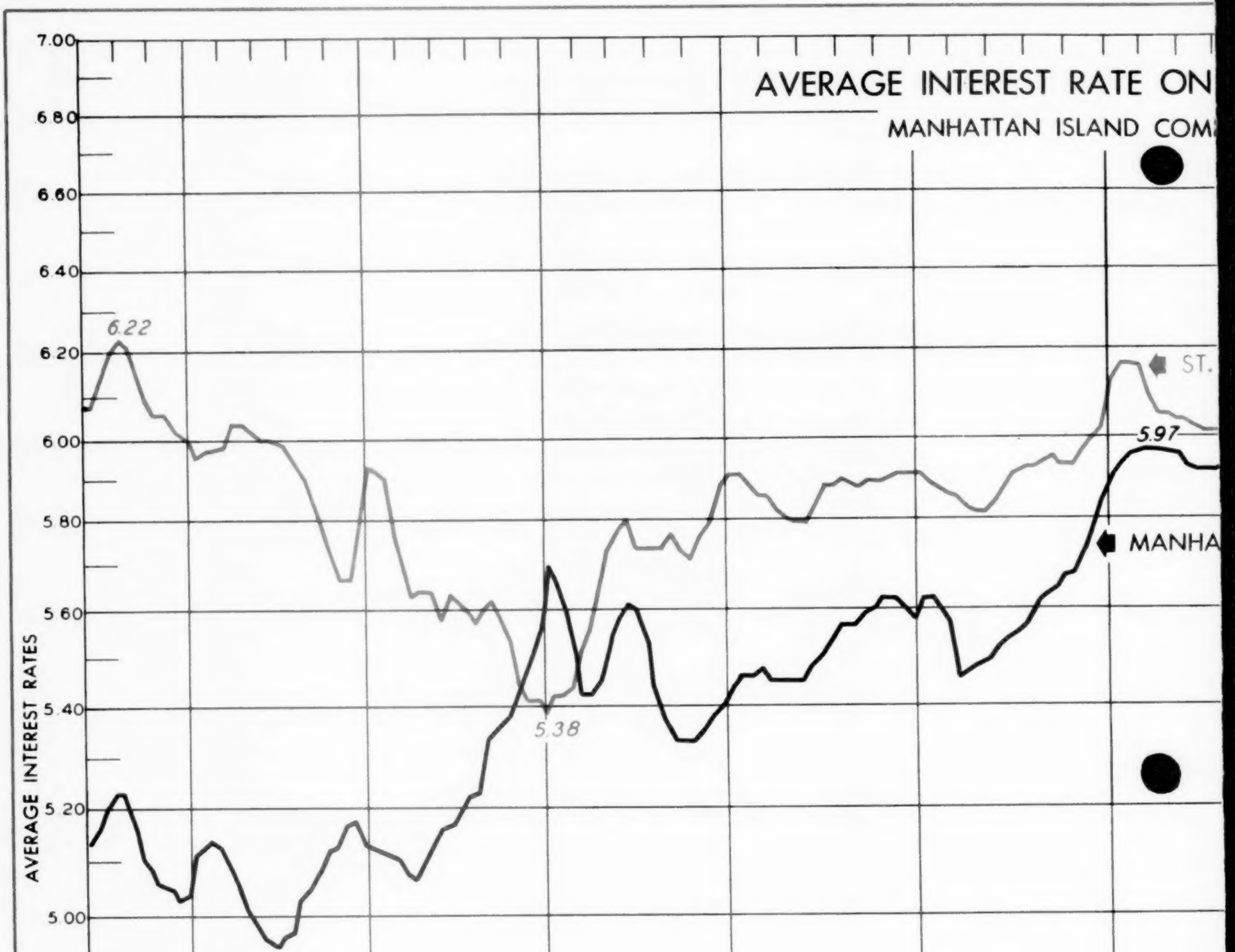
A. The prices of single-family homes are now more than double the level of 10 years ago. During the first 8 years of these 10, prices were constantly rising. During the recent past there has been a tendency for prices to weaken slightly. While it will probably not occur again, it should be kept in mind that in at least one 3-year period in the past, the average selling price of single-family residences decreased by almost one-half, and in a 7-year period decreased by more than one-half. Even though a much smaller drop in prices occurred, a 90% loan in a few years' time might be secured by a mortgage on a building which at that time, in spite of the principal payoffs made in the meantime, would be worth less than the amount still owed on the mortgage. This might even happen to a 60% loan, if a drop in real estate prices occurred similar to the drop which occurred in the thirties. Should a sizable drop occur, many lenders will be forced to take over properties the selling prices of which will not be sufficient to protect their loans.

B. In many States foreclosure proceedings are long-drawn-out and expensive. In some States it takes as long as 3 years for the lender to get possession of a property the owner of which has defaulted in his payments, and in some cases legal and other expenses involved run into thousands of dollars. During this long period taxes may become badly delinquent, maintenance is deferred, and when the property is finally secured by the lender, a considerable portion of its value may be gone.

C. Even on loans insured by the FHA, there is no guaranty that the lender will not suffer a loss. In cases of default, he must accept a debenture from the Federal Housing Administration for the amount still due on his loan. The interest rates and the terms of these debentures were set a number of years ago. With rising interest rates, it is very highly probable that these debentures would have a market value considerably below the face value which the lender would be forced to accept.

D. During the depression of the thirties, many States passed moratorium laws protecting the borrower against foreclosure, in spite of the fact that interest and principal payments were in arrears and in many cases the lender suffered considerable financial hardship through these proceedings. There is always the possibility that similar legislation might be passed in the future should real estate values drop by any large percentage.

- The lack of liquidity in real estate mortgages makes them less desirable from the standpoint of many lenders than other types of investments. A listed


AVERAGE INTEREST RATE ON
MANHATTAN ISLAND COM
AVERAGE INTEREST RATES
7.00
6.80
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6.40
6.20
6.00
5.80
5.60
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4.80
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4.00
6.22
5.38
5.97
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MANHA
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'95
1900
1905
1910
1915
1920

ALL MORTGAGE LOANS
PARED WITH ST. LOUIS
LOUIS
TTAN ISLAND
5.30
5.06
4.64
1925
1930
1935
1940
1945
1950
1955

stock can be sold on the stock exchange on a moment's notice, and the investor can have his money in less than 24 hours. The investor in a government bond or in any other listed bond can sell on the market at will should he decide that he prefers to withdraw from his investment. The depositor in a savings bank or a savings and loan association can withdraw part or all of his funds, which are insured, by the way, by the Federal government up to $10,000. The purchaser of 90-day Treasury bills can sell his bills at any time on the market, or can ride them out to maturity in 3 months. This type of liquidity to many investors has a real monetary value, as it enables them to constantly shift their position to take advantage of the best investments available at the time.

- The servicing cost on a mortgage is considerably higher than the average individual would suspect. This involves the initial cost of making the mortgage, with the necessity for reviewing and evaluating the appraisal of the value of the property and the credit report on the borrower. It also involves the necessity of seeing that the payments are made on time, that they are correctly credited, that taxes and insurance are paid on the due dates, and that any insurance losses are taken care of. It necessitates some vigilance that adequate repairs and maintenance are given the property so that its value will not be dissipated.

- Will an increased mortgage interest rate make more funds available for new construction and for the refinancing of existing properties?

The answer cannot be an unqualified "yes." With all other investment yields rising, mortgage interest rates must rise to keep the same relative position which they had before. It can certainly be said that since April 13, 4% money, even with the VA guaranty, is a thing of the past. Even in the past year it was necessary for Fanny May to subsidize these mortgages with the taxpayers' money in order to provide any market at this rate. At the present time, Fanny May has paid out approximately $2 billion for VA loans, which at today's prices in the secondary markets would entail a loss to the taxpayers of $90 million.

If the VA rate is increased to $4\frac{1}{2}$, I believe there will be money available for VA's. THERE IS NEVER A SHORTAGE OF MORTGAGE MONEY. There is only a shortage at a rate too low in comparison with the rate which can be secured by an alternate investment of funds. All other things being equal, an increased interest rate will increase the percentage of the national income which is saved and which, therefore, becomes available for investment, but all other things are not equal. The rapid increase in savings accounts and in the assets of savings and loan associations and other financial institutions has been due primarily to the inflationary policies which the government has followed. Through increasing currency and credit at the rate at which it has been increased, the actual number of dollars available for saving has increased, while the purchasing power of these dollars has gone down.

3. If home ownership is so desirable, should not the Federal government create the funds to finance borrowers, and thereby enable them to borrow at a

minimum rate?

It would be very simple for the Federal government to create the necessary dollars. This is the method which has been used during the past 20 years to finance the expansion of government to pay for World War II and to pay for all of the New Deal and Fair Deal experiments. It can be done, as it has been done, without public realization and alarm that the printing presses have been busy.

The results of this procedure, however, are always inevitably the same. Whenever the supply of currency and credit is increased faster than the amount of goods and services (and this would always be the case where money was created rather than borrowed from those who had saved it), prices will rise by a proportionate amount until the excess currency and credit is just sufficient to pay for the goods and services available.

● If home ownership, however, is of such great value, is it not worth a further increase in the cost of living to achieve?

The cost of inflation always comes right back on the public. During the past 20 years it has robbed all of those who were paying on life insurance policies, who were paying into pension funds, who had savings accounts, and all others who have purchased government defense and war bonds.

Nature has imposed double-entry bookkeeping on mankind. For every debit there must be a credit; for every gain, a loss. This is particularly true in the field of economics, so true, in fact, that one man claimed that the entire science of economics could be epitomized in the statement: "There is no such thing as a free lunch." This we have not believed in the past 20 years. Theoretically, the sum total of all goods and services will always equal in dollar price the sum total of all currency and credit which can be used for their purchase. Any person who has saved a portion of his income or who has acquired rights to a pension fund or to a portion of the reserves of a life insurance company, will find that if the currency and credit in circulation is increased, the share of future purchasing power to which he holds title will shrink. Since this is true, to create new funds out of nothing to finance the purchase of homes is merely a legalized robbery from those who have saved to benefit those who have not.

Of course, in a larger sense the government cannot create wealth by creating money, as currency and credit actually consists in purchase warrants on the total amount of goods and services. If the amount of currency and credit is increased, the number of individual purchase warrants may be increased, but the amount which can be purchased by the total number remains the same, and each individual purchase warrant will secure a smaller amount.

Bernard Baruch said: "Except for human slaughter and maiming and all that goes with them, inflation is the most destructive of all the consequences of the war." I think we might add that the history of all inflations ever experienced in

the history of the world is the history of endeavors to cheat nature.

We are probably making a false assumption, however, in assuming that a high volume of residential building cannot be done with a higher mortgage interest rate than the one to which we have been accustomed in the period we have just come through. The chart on the double spread in this report shows the average interest rate on mortgages on Manhattan Island and in St. Louis from 1893 to the present. The reason we have selected these two cities is that they represent totally different types of real estate mortgages. On Manhattan Island, most of the mortgages would be for very large amounts on multistoried buildings, while in St. Louis most of the mortgages would be on single-family residences. It is natural that the mortgage interest rate would be higher on small single-family residences than on large mortgage loans on expensive properties. The supervision required in a mortgage loan portfolio of $1 million, spread over single-family residences, is very much greater than if $1 million is invested in a single mortgage.

By comparing the chart on page 177 with the long chart on interest rates, it will be noticed that home ownership increased rapidly in periods when the average interest rate was higher than it is at the present time. This was particularly true in the period from 1920 to 1930, when the average interest rate on single-family residences was slightly more than 6%. During this period the percentage of home ownership in nonfarm areas increased from 40.9 to 46.0, an increase of 12.5%.

In my opinion, the opening for subscriptions on April 13 for the new issue of the 30-year 3-1/4% interest government bonds is the final proof that the hat is now devoid of additional rabbits, and that the period of irrational economics is coming to an end. I have said from time to time in many of my bulletins that the government could delay the effects of inflation but could not prevent them. For many years we have assumed that if we could run fast enough we could spend more than we produced, but our debts have been catching up with us, and now we are finding that we have to run very fast to stay where we are.

The return to sound economics will naturally require some adjustment. We are fortunate that the quality of the leadership in Washington will make the impact of the inevitable readjustment less severe than it otherwise might be.

ROY WENZLICK